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COMMON CARRIER OBLIGATIONS OF RAILROADS

TESTIMONY BEFORE THE
UNITED STATES SURFACE TRANSPORTATION BOARD

HEARING ON
COMMON CARRIER OBLIGATION OF RAILROADS

APRIL 24, 2008

SUBMITTED BY:

JOHN L. McINTOSH

PRESIDENT – CHLOR ALKALI PRODUCTS
VICE PRESIDENT – OLIN CORPORATION

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Chairman Nottingham, members of the Surface Transportation Board (STB), I'm pleased to be here today on behalf of Olin Corporation, which is headquartered in Clayton, Missouri. I look forward to this opportunity to testify before this Board on issues that are critical to the long-term survivability of our business.

As way of background, Olin consists of two businesses:

Winchester Ammunition is North America's leading small caliber ammunition producer with powerful global brand name recognition. Winchester provides quality ammunition to sportsmen and sportswomen around the world. We are also a major supplier to law enforcement and the U.S. military.

And **Chlor Alkali Products**.

Today, I am testifying on behalf of Olin's Chlor Alkali Products business, which is one of the leading producers of chlorine and caustic soda in North America. We have been involved in the U.S. chlor alkali industry for over one hundred years, and we were the first commercial supplier of chlorine in the United States. We continue to grow and service the chlor alkali industry. Besides chlorine and caustic soda, Olin Chlor Alkali Products manufactures and sells many derivatives of the chlorine manufacturing process, such as hydrochloric acid, hydrogen, sodium chlorate, bleach products and potassium hydroxide.

Chlor Alkali Products is headquartered in Cleveland, Tennessee and includes manufacturing sites in New York, Georgia, Tennessee, Alabama, Nevada, Louisiana, California and Washington state, plus facilities in two Canadian provinces, Quebec and New Brunswick. Each of these plants offers a favorable manufacturing cost structure, availability of highly skilled workers, ready access to our customer base, and historically competitive freight costs.

As one of the nation's leading producers of chlorine, the company produces an essential chemical that has played a key role in dramatically reducing infant mortality rates and eliminating water-borne diseases around the world. Our chlorine is also used in the manufacture of swimming pool and spa sanitizers. The biggest end use for chlorine is housing and commercial construction, in which chlorine is used to produce products such as vinyl siding, pvc piping, insulation and most paints and fire retardant additives – all products critical to the North American economy.

More than eighty percent of Olin's chlorine is transported by rail to customers who have no other option than to receive it by rail.

My testimony today will focus on the importance of the common carrier obligation as it exists today and its importance to Olin and our customers. Ostensibly, the common carrier obligation is cited by the railroads as an undue burden when it comes to the duty to transport chlorine or other TII chemicals. However, in recent years, the railroads have systematically imposed massive and unprecedented increases in chlorine freight rates, allegedly to recover their

“risk premium.” Olin has experienced average annual increases of 20% or more since 2005, and we find that by the end of 2008, our chlorine freight rates will have tripled from the average rates between 2002–2004. In one high volume move, rates were increased 177% in one year, with some rates in excess of 600% of variable costs. The railroads’ massive price increases threaten the ability of chemical shippers to keep their plants profitable and economically viable. Continued price increases would ultimately make the transport of chlorine by rail economically untenable and essentially have the same effect as the railroads refusing to ship chlorine if the common carrier obligation is eliminated.

To further explain the importance of this obligation and its effect on Olin, I must first briefly discuss our dependence on the U.S. rail industry for the safe, secure and efficient transportation of our chemical products. We appreciate that rail continues to be, by far, the safest mode of transportation in North America. For a substantial amount of the shipments from our facilities, there is no alternative to shipping by rail, and for safety and security reasons we wouldn’t want to switch. Moreover, for most of our facilities, we, the shipper, have access to only one rail carrier. These shipments are subject to what the Staggers Act refers to as “market dominance,” which is often described as being “captive” to a single railroad. For a captive shipper, regardless of its size or location, the efficient movement of its traffic – in some cases even the very survival of its business – depends on the rates and service provided by that single railroad.

Over the last hundred years, shippers like Olin have invested their money in plants and equipment based upon continuing to have the ability to ship our products economically. However, the number of railroads is decreasing, while the number of captive situations for shippers is increasing. We continue to rely on the common carrier obligation of the railroads to maintain our ability to ship product to our customers at a reasonable rate and with reasonable service. If the common carrier obligations were weakened or eliminated and the railroads declined to carry product from our manufacturing facilities to our customers, manufacturing operations would cease both at Olin and for many of our customers.

With this background, I would like to address the common carrier obligation.

Background on the Common Carrier Obligation

When considering railroad service, it is important to recognize the common carrier obligation, which is the statutory duty of railroads to provide transportation or service for shippers under 49 U.S.C. § 11101(a). The Interstate Commerce Clause of the Constitution grants power to Congress to write the laws that govern our nation’s commerce. Using this authority, Congress recognized the common carrier obligation as the framework on which the entire national railroad transportation system was founded – and it remains crucial today.

Railroads are chartered to operate in the public interest, as commerce depends on safe and reliable service in the delivery of a wide range of products. The common carrier obligation underlies the role of railroads as a service industry that supports so many critical sectors of the U.S. economy. Our federal courts have pointed out that even if it is inconvenient or unprofitable

for a railroad to carry a particular product, the common carrier doctrine obligates a railroad to provide this service.

Also, Congress never intended for the common carrier obligation to be dependent on whether the railroads can operate without negligence or derailments. The failure of the railroads to prevent dangerous and avoidable derailments cannot be a reason to deny service to shippers, like Olin, under the common carrier obligation. To illustrate this, the National Transportation Safety Board has found that in the three fatal tank car accidents since 2002, the cause was either maintenance or operational errors on the part of the railroads, yet the railroads insist on passing along the “risk premium” in questionable pricing actions or attempt to renege entirely on their legal obligations based solely on their negligence in failing to keep trains from crashing.

Minot, North Dakota – faulty track and poor maintenance caused a derailment.

Macdonia, Texas – crew fatigue resulted in a collision.

Graniteville, South Carolina – improper switching in “dark territory” caused a collision.

Summary

The common carrier obligation was established by Congress to protect all rail shipments, including chemicals such as chlorine. As this testimony demonstrates, the STB must enforce the common carrier obligation imposed by Congress for all of the aforementioned reasons. The ability of American manufacturers and producers to compete in today’s global market is highly dependent on the railroads’ compliance with the common carrier obligation. Today, unfortunately, the railroad industry impedes – rather than enables – our nation’s global competitiveness. American manufacturers and producers find it more and more difficult to remain competitive against manufacturers and producers outside the United States. The lack of compliance with the common carrier obligation will continue to impair the ability of the U.S. rail industry to serve all of its customers and no doubt lead to more outsourcing of high-paying American jobs.

My written comments address the first seven enumerated topics in the hearing notice, as well as touch on the role of the STB Office of Compliance and Consumer Assistance. The hearing notice also allows for a discussion of topics which are not enumerated, but have a relationship to the common carrier obligation, and I have also provided comments on such topics.

Thank you for allowing Olin to present its views on the common carrier obligation, and I would be glad to respond to any questions.

Discussion of items enumerated in the STB Hearing Notice

1. Service limitation resulting from a capacity constrained environment

Olin recognizes that railroads are experiencing capacity constraints. However, Congress did not intend for capacity constraints to be a reason to deny service under the common carrier

obligation. The railroads tell us that demand exceeds their ability to provide reliable service in key chemical traffic corridors. We understand that the bottleneck impact of slower train speeds and increased dwell times for cars in terminals are issues. In fact, we have spent money to increase our fleet based upon increased dwell times. However, our experience as a shipper is that these rail capacity constraints have seemed to level off and are manageable.

Even with the capacity constraints that railroads are facing, they continue to be highly profitable. To illustrate this, we, at Olin, reviewed the stock prices of the following five largest U.S. railroads from January 5, 2005 (the day of the horrible accident at Graniteville, South Carolina) to April 3, 2008: Norfolk Southern Corporation; Union Pacific; Burlington Northern Santa Fe and CSX. These five railroads have each had their stock prices increase an average of 125.6% since the Graniteville accident on January 5, 2005. These numbers demonstrate that railroads continue to be very profitable while at the same time continuing to charge shippers higher and higher freight charges.

2. Cost and safety issues related to the transportation of hazardous materials, especially toxic inhalation hazards

Congress did not intend for cost and safety issues for railroads to be a reason to deny service under the common carrier obligation. Olin recognizes that the railroads have maintained that there are increased cost pressures because of liability and safety concerns. With respect to liability, Olin has not been privy to what liability insurance is available to the railroads at what cost. However, we have seen significant pricing increases as the railroads have tacked on the "risk premium" to cover their alleged increased costs. Perhaps the STB might look at this issue, as it did with the fuel surcharge issue. See *Surface Transportation Board Decision, Rail Fuel Surcharges* (STB Ex Parte No. 661, 2007 WL 201205 (January 26, 2007).)

With respect to safety, Congress did not intend for the common carrier obligation to be conditioned on whether a chemical is or is not a toxic inhalation hazard. Rather, the duty applies to all shipments by rail. Under this obligation, railroads are required to carry substances such as chlorine or ammonia. Furthermore, in any discussion of chlorine shipments, it is very important to focus on the exemplary safety record of these shipments. To illustrate this, according to the Chlorine Institute, of the 1.5 million chlorine tank shipments since 1965, there have been 11 breaches of a tank car, representing only 0.00073 % of all shipments.

Olin is committed to continuous improvement of our very strong safety record of accident prevention at our chlorine manufacturing facilities. Furthermore, we are focused on working with the railroads to enhance rail transportation safety through the development of new technologies. Rail safety is the result of multiple factors including train operations, track conditions, car placement and car design.

3. Carrier-imposed requirements for infrastructure investments by shippers

Congress did not intend that adherence or a lack of adherence to any railroad-imposed infrastructure investment requirement for the shippers would be a reason to deny service under the common carrier obligation.

Olin is vitally interested in the financial health of America's railroads. We simply cannot operate successfully in this country without a financially viable railroad industry and a secure railroad infrastructure. Thus, it is in Olin's best interest to support reasonable infrastructure investment for the railroads.

The railroads are proposing a 25% investment tax credit and first year expensing for infrastructure investments. Olin continues to support the proposed railroad investment tax credit with certain stipulations. We could potentially benefit from this tax credit in upgrading plant rail yards to accommodate heavier tank cars of new design. While some level of investment tax credit for infrastructure is appropriate, it must be part of a comprehensive solution to rail reliability problems. Olin believes that the access to these tax credits should be tied to railroad service and safety performance metrics. Moreover, a significant portion of these tax credits must be used to improve railroad infrastructure for domestic shipments – not just for intermodal imports to Western ports. Most importantly, Olin is supportive of approval of this tax credit contingent upon congressional approval of both the STB reform and railroad antitrust legislative bills.

4. The impact of volume requirements or incentives

Congress did not intend for railroad-imposed volume requirements or incentives on large captive shippers, such as Olin, to be a reason to refuse shipments under the common carrier obligation.

5. Economically motivated service reductions and metering of the demand for service

Congress intended that under the common carrier obligation, shippers are entitled to consistent and reasonable service from the railroads irrespective of any alleged economic motivations for service reductions. The railroads have already structured service levels to our manufacturing plants to facilitate their operational efficiencies. Olin and its customers have based their manufacturing decisions, including rail car requirements, on the railroad service level. Any further reductions will place an undue burden on Olin and its customers. Most importantly, the common carrier obligation requires railroads to switch full rail cars when needed by the shippers, as well as to provide turnaround of empty cars when needed by the shippers. Otherwise, the consumers down the manufacturing line are impacted by inappropriate service by the railroads.

6. The proper use of rail embargoes

Congress intended that, under the common carrier obligation, railroads would act in good faith with respect to any potential rail embargoes. We recognize that force majeure-type events can result in logistical difficulties which are outside the control of railroads. However, such alleged difficulties for the railroads cannot be an excuse for failure to meet their common carrier obligation and responsibility, or the basis for trying to exit the TIH shipping business.

7. When it becomes necessary to obtain abandonment authorization

Congress never intended that railroads could use the abandonment of rail track as a way to escape their common carrier obligation. For most of our facilities, we only have access to one rail carrier. As a result, the consequence of track abandonment would be the ending of rail service to our manufacturing facilities and shutdown of our facilities.

8. To whom does the common carrier obligation apply

Olin has no comment to this request.

STB's Office of Compliance and Consumer Assistance

The Office of Compliance and Consumer Assistance (OCCA) is supposed to ensure that rail operations are consistent with each railroad's statutory and regulatory responsibilities. Even though Olin continues to witness rail activity which is inconsistent with the common carrier obligation, we have not seen any examples of enforcement activities by the OCCA with respect to this obligation. On the other hand, the offices of the STB, including OCCA, have continued to support policies that curtail competition between railroads and that have generally harmed captive shippers. Olin is strongly supportive of comprehensive and aggressive enforcement of the common carrier obligation by the OCCA.

Topics related to the common carrier obligation which were not enumerated in the STB hearing notice.

1. Pricing Chlorine Off the Rails

Olin has continued to be subjected to higher and higher freight and fuel rate-based surcharges from the railroads. For example, in 2006 alone, rail freight rates increased by 20% for Olin. In 2007, rail freight rates increased by more than 20%. Furthermore, rail fuel surcharges have also continued to increase for shippers. In fact, the STB has appropriately questioned the legality of rate-based surcharges for regulated traffic, and there are many class action lawsuits against the railroads for contract traffic. These lawsuits allege that the railroads, in setting fuel surcharges under private contracts, have acted in violation of antitrust laws, and the shippers seek damages for such overcharges.

It appears to us that railroads are attempting to make it cost-prohibitive for chemical companies, like Olin, to continue shipping chlorine. Railroads are effectively pursuing this policy by the increase in rates, fuel surcharges, fees and other efforts. The intention of the railroads appears to be to make it too expensive for chemical companies to ship essential chemicals, such as chlorine, which are a backbone of our public health and economy. Under the common carrier obligation, there must be reasonable rates for shippers. The common carrier obligation is dependent on the rail rates being fair and equitable. The current freight and fuel rates that shippers are paying are not fair and equitable. This is reflected in larger earnings and share price increases for the railroads.

2. Chlorine is essential to the nation's health, economy and security

Chlorine is essential to this nation's health, economy and security. Because of the importance of chlorine, the question of compliance by the railroads with the common carrier obligation has extremely negative repercussions on the U.S. economy.

According to the Chlorine Institute, chlorine products of all kinds and their derivatives are associated with 45% of the nation's Gross Domestic Product. The chlor alkali industry alone contributes over seven billion dollars directly to the U.S. economy each year.

Chlorine chemistry is essential to everyday life. The products of chlorine chemistry make possible clean water and safe foods, pharmaceuticals, medical equipment, construction materials, computers, electronics, automobiles, clothing, sports equipment, agriculture, and much more. For the majority of these applications, there are no reasonable substitutes for chlorine.

In addition to being important to our nation's health and economy, chlorine is vital to U.S. security. The Department of Homeland Security has deemed chlorine as an essential asset to the "critical infrastructure." Moreover, chlorine is used in materials which promote national defense, such as bullet-proof vests, helmets, parachutes, etc. Chlorine is helping to protect the men and women in our armed services.

3. The importance of free market conditions to the common carrier obligation

In our free market economy, monopolies result in both poor service and high prices. Because of massive consolidation, 90% of the nation's rail traffic is handled by only five major railroads. As the inevitable result, whole states, regions and industries are now captive to a single railroad. Now, it appears that the railroads don't even want to serve chemical shippers.

Monopolistic conditions for the railroads make it even more difficult for the common carrier obligation to be met. When there ceases to be rail competition, there is less of an incentive for railroads to meet their statutory common carrier obligation. When there is more rail competition, there is a competitive inducement for railroads to meet their common carrier obligation by providing the best possible service to shippers.

You can imagine the difficulty that shippers like Olin face when it comes time to negotiate a rail contract or a rail rate for a captive facility. Lacking the negotiation flexibility and bargaining power that competition provides, freight rates from the monopolistic railroads continue to rise unchecked. As a result, shippers and the American consumer have paid a very high price for U.S. rail industry gains. That's because competition – the hoped-for result sparked by the Staggers Act – has come to a grinding halt.